Good MornING Asia - 24 October 2019

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- **General Asia:** Absent any developments on trade or Brexit fronts, the monetary policy is likely to be a dominant theme for the markets as central banks in Europe and Indonesia meet today. In Asia, Korea's stable GDP growth in the third quarter followed a similar outcome in Singapore last week. This is a hopeful sign that the Asian growth cycle is close to its trough and so is the central bank policy easing cycle.
- **Philippines:** Bangko Sentral ng Pilipinas is monitoring the effect of recent reductions to the reserve requirements (RRR) in the wake of a hefty 300 bps cut this year. Monetary Board member Tolentino indicated that they would like to see the impact of these reductions on bank lending before cutting further. Previously, Governor Diokno hinted at further cuts and we're penciling the 4th RRR cut before the year-end.
- **Indonesia:** Bank Indonesia (BI) meets today with the market pricing in another 25bp policy rate cut to 5.00%, the fourth cut this year. Inflation has been firmly within BI's target. So, President Jokowi's recent push for growth may prod the central bank to cut policy. And with the inflows in the bond market supporting the IDR around 1400, the door remains open for BI rate cut today.
- **Singapore:** Slower increases in food, fuel and utilities, communication, and education components were behind three-year low core CPI inflation of 0.7% YoY in September from 0.8% in August. The headline inflation was steady at 0.5% over these months. The year-to-

date average core inflation of 1.2% is consistent with the MAS view of the full-year print close to the low end of its 1-2% forecast range. The central bank's forecast for the headline inflation this year is 0.5% (0.6% YTD). Activity data continues to underscore the need for greater policy support to the economy.

- **Malaysia:** The low inflation trend is here to stay. We have cut our inflation forecast for the current year to 0.7% from 0.8% and for the next year to 1.2% from 1.4%. With persistent external headwinds to growth, one more Bank Negara policy rate cut this year won't hurt. Don't be surprised if we get one in the next BNM meeting on 5 November.

What to look out for: ECB meeting and BI meeting

- Hong Kong trade (24 October)
- Bank Indonesia meeting (24 October)
- ECB meeting (24 October)
- US durable goods and new home sales (24 October)
- Singapore industrial production (25 October)
- Thailand GIR (25 October)

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Article | 23 October 2019 **Malaysia**

Consumption tax distortion to Malaysia's inflation is over

The low inflation trend in Malaysia is here to stay, leading a further downgrade of our inflation forecast this year to 0.7% and for the next year to 1.2%. With persistent external headwinds to growth, one more Bank Negara policy rate cut this year won't hurt. Don't be surprised if we get one at the next BNM meeting on 5 November

Kuala Lumpur, Malaysia

1.1% Malaysia inflation

September

Lower than expected

Downside inflation miss

Malaysia's consumer price index (CPI) rose less than expected, by 1.1% year-on-year in September, against the consensus forecast of a 1.3% rise. The inflation rate is down from 1.5% in August as

most CPI components posted slower increases. Food, housing, and transport get the most attention given their combined 69% weight in the CPI basket -- all posting lower inflation in the last month.

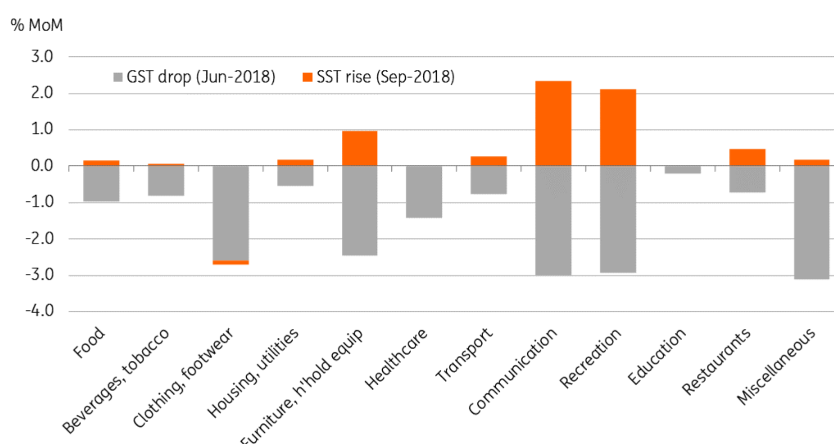
However, the September inflation slowdown is more of a reflection of what happened a year ago – the consumption tax distortion – than what's happening now. The headline CPI index was, in fact, unchanged in September from its level in August.

Consumption tax distortion

CPI data from June to September this year was distorted by the consumption tax overhaul carried out by the Mahathir administration a year ago. Its first move was the scrapping of the Goods and Services Tax (GST) from June 2018. This dented inflation below 1% in that month from an average of 1.7% in the first five months of 2018. Then came the replacement of GST with a more benign Sales and Service Tax (SST) from September 2018, though the inflationary impact of this policy was much muted.

The low base effect resulting from the GST removal pushed inflation back above 1% to 1.5% in June this year. And the high base effect from the SST introduction worked in the opposite direction to reverse some of that spike in September.

Consumption tax impact on consumer prices



Source: Bloomberg, ING

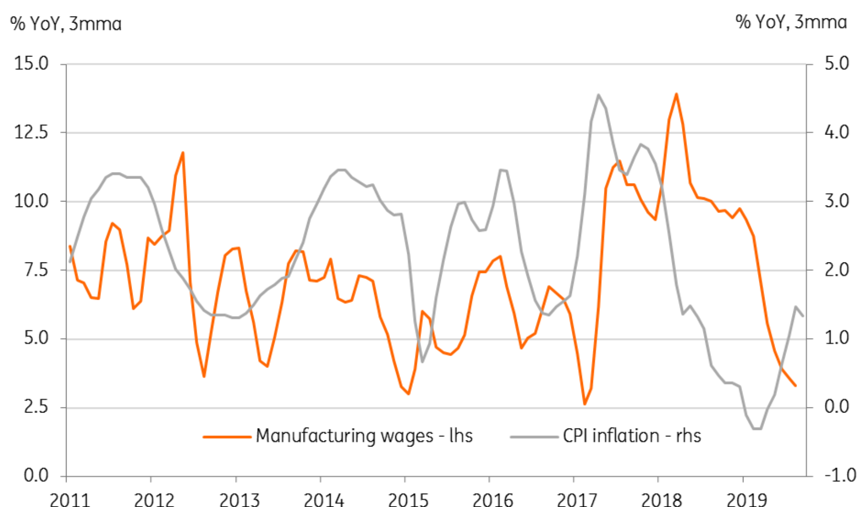
The month-on-month change in CPI components in June 2018 when the GST was scrapped, and in September 2018 when the SST was introduced.

It's also about weak demand

With the consumption tax distortion behind us, supply and demand forces will be the clear inflation drivers in the period ahead. A supply disruption to food prices from flash floods in Kuala Lumpur and other parts of the country poses an upside risk while low fuel and transport prices continue to exert downward pressure on headline CPI.

The current low inflation also reflects weak domestic spending. Wage growth has been on a steady downward pressure this year. At 3.3% YoY in August wage growth in the manufacturing sector has decelerated sharply from 10% at the end of 2018. No doubt this will be associated with weak consumer spending.

Slowing wage growth weighs on spending



Source: Bloomberg, ING

More reasons for monetary policy easing

We see inflation hovering around 1% through the rest of the year, nudging down our full-year forecast slightly to 0.7% from 0.8%. We don't see any inflation risk in 2020 either and we're cutting our forecast for next year to 1.2% from 1.4%.

Growth also faces downside risks ahead. Even if the Malaysian economy outperforms its Asian neighbours in terms of growth in the first half of 2019, sustaining that performance ahead will be a challenge as the global headwinds to the export-dependent economy become stronger. There have been some weak signals recently underpinning this.

We believe one more pre-emptive Bank Negara Malaysia (BNM) policy rate cut in the current quarter won't hurt. Today's inflation figure strengthens this view further. We see a 25 basis point cut in the BNM overnight policy rate to 2.75% at the next and the last of this year on 5 November.

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Article | 23 October 2019

Singapore

Singapore’s core inflation dips to three-year low

Widening of the negative output gap suggests inflation is likely to remain subdued for a prolonged period

0.7%

September core inflation

Lower than expected

Steady headline, lower core inflation

Consistent with the consensus view, Singapore's inflation rose by 0.5% year-on-year in September - unchanged from August. However, core inflation surprised on the downside with a dip to 0.7% from 0.8% - the lowest rate in more than three years since April 2016 (consensus 0.8%).

While the headline inflation has been in line with the central bank's forecast of 0.5% this year, core inflation has drifted below the 1-2% forecast range.

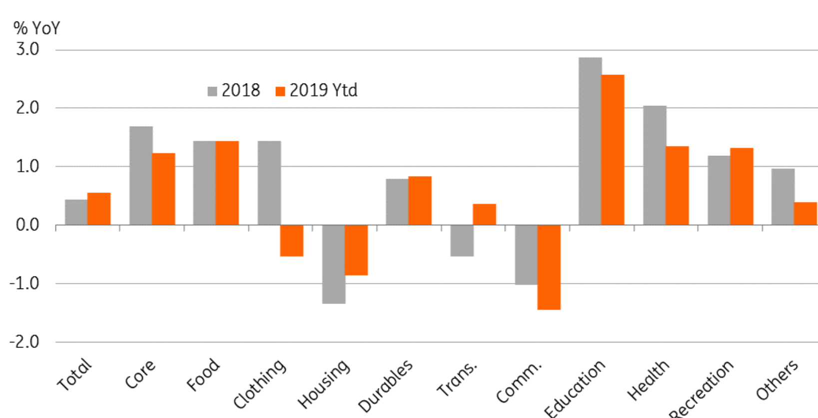
What dented core inflation?

Slower increases in food, fuel and utilities, communication, and education components were responsible for lower core inflation.

Unlike the convention of excluding food and fuel prices, core measure in Singapore take out the accommodation subcomponent of the housing component and the private road transport subcomponent of the transport component from total CPI. While there was a slight improvement in the accommodation part, it was offset by weakness in the private road transport prices.

Clothing, healthcare and recreation components bucked the trend in September – all posting faster increases (slower fall in case of the clothing component).

Consumer price inflation by components



Source: Bloomberg, ING

Conflicting policy

Singapore's economy is already flirting with a recession. A widening of the negative output gap suggests inflation is likely to remain subdued for a prolonged period. These trends are in contrast with Singapore's macroeconomic policy that's bucking the global trend of easing. Last week, the central bank kept its tightening policy bias albeit with a slight reduction in the pace of SGD NEER appreciation.

Unfortunately, monetary policy is now fixed for the next six months so this shifts the onus on fiscal policy, which also looks unlikely to deliver a meaningful boost. Barring any improvement in the external trade environment, the economy is in for continued slow growth and low inflation in the near term.

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Snap | 23 October 2019 **Taiwan**

Even smartphones can't rescue Taiwan's production data

Taiwan's industrial production is contracting despite the better-than-expected smartphone sales. We now think smartphones can't really do very much for the overall economy

Following moderate positive growth in July and August, we were surprised to see Taiwan's industrial production contract by 0.75% year-on-year.

We had hoped that better-than-expected smartphone sales would help the economy and industrial production, but it seems that we were too optimistic.

We have already seen that smartphone sales provided little support to overall exports and the same now goes for industrial production now. Even though smartphone and supply chain production has been growing positively with electronic items growing by more than 24%YoY and electronic parts production growing by 3%YoY, they can't seem to prevent overall manufacturing from contracting.

Expect industrial production to remain in contraction territory

If overall global demand for electronics is slowing down, then Taiwan's industrial production is unlikely to start growing any time soon given that it is a manufacturing hub for electronics. Until

5G becomes widely available and there is a wave of demand for new smartphones and other electronic equipment, Taiwan's manufacturing industry is likely to remain in contraction territory.

It also seems that the policy to attract manufacturers to move factories from mainland China to Taiwan hasn't worked very well. According to news reports, lack of water, electricity, workers and the appropriate talent pool to start production when manufacturers move is a problem. Lack of infrastructure is not an easy issue problem to solve and can take years to resolve if not properly planned. Wages are also likely to rise given the limited size of the population.

> It is difficult to find a positive aspect that might support an uptrend in Taiwan's manufacturing, apart from a temporary strong increase in smartphones sales.

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